Handling Whistleblowers:
Best Practices in Responding to Allegations

by

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I. THE BASICS

A. THREE KEY ELEMENTS

1. Rewards for Individuals Who Report Possible Securities Law Violations to the SEC

2. Protection Against Retaliation

3. Prohibition Against Impending Communications to the Commission

B. KEY PROVISIONS


2. Rewards for Individuals

   (a) Section 21F(b) authorizes the Commission to provide a monetary award to “whistleblowers” who voluntarily provide original information to the Commission that leads to an enforcement action resulting in monetary sanctions of more than $1 million

   (b) The award is between 10 percent and 30 percent of the monetary sanctions collected

   (c) In deciding on the amount of the award, the Commission considers, among other factors, the significance of the information provided by the whistleblower to the success of the action and the degree of assistance provided by the whistleblower or his or her legal representative in the action
3. Protection Against Retaliation

(a) Section 21F(h) protects whistleblowers against retaliation. It provides:

“No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower – (i) in providing information to the Commission, (ii) in assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information, or (iii) in making disclosures that are required or protected under any law, rule, or regulation subject to the jurisdiction of the Commission”

(b) An individual who proves retaliation is entitled to reinstatement, two times the amount of back pay with interest, and compensation for litigation costs, expert witness fees, and reasonable attorney’s fees

4. Prohibition Against Impeding Communications to the SEC

(a) The Commission’s whistleblower rules are codified at 17 CFR 21F-1 to 21F-17. Rule 21F-17(a) provides:

“No person may take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement with respect to such communications”

C. TIPS AND AWARDS

1. As of January 2020, the SEC had awarded more than $387 million to 67 whistleblowers related to SEC enforcement actions that resulted in more than $2 billion in total monetary sanctions

2. In FY 2019, the Commission received 5,212 whistleblower tips, which is the second largest number of total whistleblower tips in a given year and represents a 74% increase since the beginning of the program

(a) FY 2018 had the largest amount of total whistleblower tips of any year, totaling 5,282.

3. In FY 2019, the SEC made its third largest award to date, a $37 million award. The Commission’s two largest awards to date, a $50 million award and a $39 million award, both occurred in FY 2018

4. In FY 2019, the Commission issued awards totaling nearly $60 million to 8 individuals
5. In FY 2019, the Commission received tips from individuals in every state as well as from individuals in 70 countries outside the United States, and three of the eight award recipients were located abroad or reported conduct occurring abroad.

6. The Commission also received over 300 tips related to cryptocurrencies, which the Commission considers an emerging area of interest.

7. The SEC’s Office of the Whistleblower currently is tracking over 1,000 matters in which a whistleblower’s tip has caused a Matter Under Inquiry or investigation to be opened or which has been forwarded to the Enforcement staff for consideration in connection with an ongoing investigation.

8. Former SEC Chair Mary Jo White and Former SEC Enforcement Director Andrew Ceresney each described the whistleblower program as having had a “transformative” effect on the Commission’s enforcement program.

D. OTHER WHISTLEBLOWER AWARD PROGRAMS

1. The Dodd-Frank Act also created a new whistleblower program at the U.S. Commodity Futures Trading Commission (CFTC), and in May 2017, the CFTC strengthened anti-retaliation protections for whistleblowers.

2. The False Claims Act.

3. State whistleblower award programs.

E. RECENT DEVELOPMENTS

1. Digital Realty Trust, Inc. v. Somers: On February 21, 2018, the U.S. Supreme Court held that Dodd-Frank’s whistleblower anti-retaliation provisions do not protect employees who report securities violations only to their employers. Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018). This decision resolved a split among the circuits and invalidated the Commission’s rule interpreting the provision’s anti-retaliation protections to apply regardless of whether the employee reported to the Commission, a different government agency, or internally to the employer.

   (a) In light of Digital Realty, whistleblowers who report internally rather than to the SEC are excluded from protection under Dodd-Frank. Their avenues for relief are limited to state-law claims and private actions under Sarbanes-Oxley, which, unlike Dodd-Frank, does not provide as direct of a potential path to federal court. Nevertheless, retaliation against whistleblowers remains illegal, and the SEC emphasized that it remains an area of focus, even after Digital Realty.

   (b) Retaliation claims may not always lead to federal court, at least initially. On September 19, 2019, the Second Circuit held that retaliation claims brought under Dodd-Frank are not barred by law from arbitration. Daly v.
Citigroup, 939 F.3d 415 (2d Cir. 2019). The Third Circuit had previously reached a similar conclusion in Khazin v. TD Ameritrade Holding Corp., 773 F.3d 488 (3d Cir. 2014). The plaintiff employee filed a petition for writ of certiorari to the Supreme Court on December 19, 2019.

2. In July 2018, the Commission published a proposed rule clarifying whistleblower protections in light of Digital Realty. Whistleblower Program Rules, 83 Fed. Reg. 34,702 (July 20, 2018). Proposed Rule 2F-2(a) would align with the Supreme Court’s decision by conferring whistleblower status only on “(i) an individual (ii) who provides the Commission with information ‘in writing’ and only if (iii) ‘the information relates to a possible violation of the federal securities laws.’” Id. at 34,718.

(a) In addition to the updated definition of a whistleblower, the Commission also proposes: allowing the payment of awards based on money collected under deferred prosecution agreements and non-prosecution agreements entered into by the DOJ or a state attorney general; eliminating double recovery under the current definition of “related action” by clarifying that a law enforcement action would not qualify as a related action if there is a separate whistleblower award scheme that more appropriately applies; and allowing the Commission to adjust small awards upwards and exceedingly large awards downwards. Id. at 34,703-04.

(b) The Commission is still considering public comments received on the proposed amendments.

3. In September 2019, a bipartisan group of Senators introduced the Whistleblower Programs Improvement Act to extend protections for individuals who report violations of securities laws. The bill is similar to the Whistleblower Protection Reform Act of 2019, which passed the House by a bipartisan majority of 410-12 in July 2019. Both the Senate and House bills would extend whistleblower protections to employees who report violations internally, which would reverse the outcome of the Supreme Court’s decision in Digital Realty. Additionally, the current Senate bill would add an anti-arbitration provision to Dodd-Frank, which would make an agreement to arbitrate a retaliation claim under Dodd-Frank invalid and unenforceable.
II. BEST PRACTICES: POLICIES AND PROCEDURES

A. INTERNAL REPORTING: consideration of appropriate corporate constituencies to be informed of a complaint, including members of senior management, the Board, the Audit Committee, and outside auditors

B. DEFINING A WHISTLEBLOWER COMPLAINT: assessing which complaints trigger risks and responsibilities under governing laws and regulations

C. TREATMENT OF WHISTLEBLOWERS
   1. Ensuring Confidentiality of Whistleblowers
   2. Communications with Whistleblowers: developing the facts, providing appropriate assurances and managing risks
   3. Prohibition Against Impending Communications to Regulators (discussed in more detail below): avoiding allegations that communications with regulators are interfered with
   4. Anti-Retaliation (discussed in more detail below)
   5. Potential Ombudsman Role

D. COMPLAINT TRACKING AND DOCUMENTATION

E. DOES EVERY COMPLAINT REQUIRE AN INVESTIGATION?
   1. Determine who investigates (legal, compliance, internal audit, outside counsel)
   2. Determine who oversees the investigation
      (a) OSHA, which is charged with enforcing anti-retaliation provisions under nearly two dozen federal statutes including Sarbanes-Oxley, issued guidance in 2017 that includes, among many other provisions, the following: “if possible, make the anti-retaliation investigation completely independent from the corporation’s legal counsel, who is obligated to protect the employer’s interests” (OSHA, Recommended Practices for Anti-Retaliation Programs,” (January 13, 2017)

F. INVESTIGATIVE PROTOCOLS
   1. Time period for commencing and completing an investigation
   2. Document preservation and collection
   3. Protocols for conducting interviews and who attends
   4. Statements regarding confidentiality
5. Involvement of non-lawyers and the risks of creating new whistleblowers

6. Documentation/work papers

G. REPORTING THE RESULTS OF THE INVESTIGATION

III. BEST PRACTICES: WHETHER AND WHEN TO REPORT TO REGULATORS

A. SELF-REPORTING IS NOT REQUIRED UNDER DODD-FRANK, BUT

1. FINRA Rule 4530(b)

2. Conduct that has a “widespread or potential widespread impact”

3. Conduct that arises from a “material failure of the firm’s systems, policies or practices involving numerous customers, multiple errors or significant dollar amounts”

4. Self-reporting may be required in other jurisdictions (e.g., Hong Kong Securities and Futures Commission requirement to self-report immediately any actual or suspected material breach, infringement, or non-compliance with certain laws)

B. OPTIONAL SELF-REPORTING

1. The continuing guidance from the SEC’s Seaboard Report

2. The SEC’s Non-Prosecution Agreement with Ralph Lauren Corp.

C. LAWYER’S DISCLOSURE OF INFORMATION UNDER 17 CFR §205.3:

A lawyer appearing and practicing before the Commission may disclose confidential information to the Commission that the lawyer reasonably believes is necessary: “(i) to prevent the issuer from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors; (ii) to prevent the issuer, in a Commission investigation or administrative proceeding, from committing perjury…; or (iii) to rectify the consequences of a material violation by the issuer that caused, or may cause, substantial injury to the financial interest or property of the issuer or investors in the furtherance of which the attorney’s services were used.”

D. TIMING

E. METHODS OF SELF-REPORTING

IV. BEST PRACTICES: AVOIDING RETALIATION CLAIMS

A. BACKGROUND

1. Whistleblowers Were a Protected Class Long Before Dodd-Frank
(a) Sarbanes-Oxley Prohibition Against Retaliation

(b) The Occupational Safety and Health Administration, to which Sarbanes-Oxley retaliation claims must be brought, enforces anti-retaliation claims under twenty-two federal statutes

(c) State Statutory and Common Law Prohibitions Against Retaliation

(i) Many states have specific statutes prohibiting retaliation against whistleblowers

(ii) Some states have common law actions for retaliation against whistleblowers

(iii) Retaliation claims have also been brought based on violations of the implied obligation of good faith

2. Impact of Dodd-Frank (Section 21F(h)(1)(A) and SEC Rule 21F-2(b))

(a) Six-year statute of limitations vs 180-day requirement under Sarbanes-Oxley

(b) Immediate access to federal courts (unless an arbitration provision applies), rather than requirements that claim first be filed with OSHA

(c) Can get double back pay, (as well as reasonable attorney’s fees and expert witness fees under Dodd-Frank) as opposed to single back pay under Sarbanes-Oxley

(d) Under Dodd-Frank, both the SEC and the whistleblower may bring retaliation actions

B. SEC RETALIATION ENFORCEMENT ACTIONS

1. In the Matter of Homestreet, Inc., et al., Exchange Act Rel. No. 79844 (Jan. 19, 2017) (charging company with violating Rule 21F-17(a) by, among other things, suggesting to an employee that the terms of an indemnification agreement could allow the company to deny payment for legal costs if the employee was a whistleblower, and requiring former employees to sign severance agreements waiving potential whistleblower awards or risk losing their severance payments and other post-employment benefits)

2. In the Matter of SandRidge Energy, Inc., Exchange Act Rel. No. 79607 (Dec. 20, 2016) (charging company with violating Rule 21F-17 by, among other things, firing an internal whistleblower who kept raising concerns about the process used by the company to calculate its publicly reported oil-and-gas reserves (despite good performance), and requiring departing employees to sign a separation agreement with language prohibiting them from disclosing confidential
information without prior consent of the company or voluntarily cooperating with any government agency in a complaint or investigation concerning the company)

3. *International Game Technology*, SEA Release No. 78991 (September 29, 2016) (three months after an employee raised concerns to his managers, the complaint hotline, and the SEC that its financial statements may have been misstated, the firm terminated him despite prior positive performance evaluations)

4. *Paradigm Capital Management*, IAA Release No. 3857 (June 16, 2014) (after learning that a trader complained about principal transaction violations to the SEC, the firm changed his job from head trader to compliance assistant and stripped him of his supervisory responsibilities)

C. BEST PRACTICES

1. Providing channels that allow employees to report concerns anonymously if that is their preference

2. Protecting the anonymity of employees who report concerns

3. Clearly identifying whistleblower retaliation as a form of misconduct in policies and procedures

4. Ensuring that employment status changes, including denials of promotion, are only made for legitimate non-retaliatory reasons

5. If disciplinary action is taken against a whistleblower, having it reviewed by someone who was not involved in the whistleblower incident

6. If an employee claims he or she has experienced retaliation, providing an independent channel for reporting retaliation and independent review by a person not involved in the whistleblower complaint

7. Protecting employees from retaliation even if their claims are determined to be unfounded

8. Providing training on anti-retaliation

9. If retaliation is found to have occurred, remediating it quickly

V. BEST PRACTICES – CONFIDENTIALITY AGREEMENTS

A. BACKGROUND

1. Rule 21F-17(a) prohibits any person from taking action to impede an individual from communicating directly with the SEC staff about a possible securities law violation
B. CASES

1. Recent pending or settled SEC matters finding violations of Rule 21F-17 in connection with separation agreements and confidentiality agreements:

(a) *SEC v. Collector’s Coffee, Inc.*, No. 19-04355 (S.D.N.Y. Nov. 4, 2019) (filing amended complaint charging company and CEO with, among other things, violating Rule 21-F by responding to allegations of fraud by signing stock purchase and settlement agreements that contained explicit provisions impeding investors from communication with the SEC and then suing investors for allegedly breaching their confidentiality agreements by speaking with the SEC)


(c) *In the Matter of BlackRock, Inc.*, Exchange Act Rel. No. 79804 (Jan. 17, 2017) (charging firm with violating Rule 21F-17 by requiring departing employees to sign a separation agreement with language by which the employees purportedly waived recovery of incentives for reporting misconduct available under, among other things, the Dodd-Frank Act)


(e) *In the Matter of NeuStar, Inc.*, Exchange Act Rel. No. 79593 (Dec. 19, 2016) (charging company with violating Rule 21F-17 by requiring departing employees to sign severance agreements that contained a broad non-disparagement clause forbidding former employees from engaging with the SEC and other regulators “in any communication that disparages, denigrates, maligns or impugns” the company)

(f) *In the Matter of Anheuser-Busch InBev SA/NV*, Exchange Act Rel. No. 78957 (Sept. 28, 2016) (charging company with violating, in relevant part, Rule 21F-17 by requiring an employee to enter into a severance agreement prohibiting the employee from voluntarily communicating with the SEC about potential FCPA violations due to a substantial financial penalty that would be imposed for violating strict non-disclosure terms; the company had used similar language in past severance agreements)

(g) *In the Matter of Health Net, Inc.*, Exchange Act Rel. No. 78590 (Aug. 16, 2016) (charging company with violating Rule 21F-17 by, among other things, requiring departing employees who desired severance benefits to sign severance agreements with language prohibiting them from receiving a whistleblower award)